A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Department of Revenue

For the Two Fiscal Years Ended June 30, 2008

DECEMBER 2008

LEGISLATIVE AUDIT
DIVISION

08-14

Financial-Compliance Audits

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December 2008

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Revenue for the two fiscal years ended June 30, 2008. Included in this report are seven recommendations related to unrecorded liabilities, accounting misclassifications, the Internal Service Fund rate, unauthorized investments, excess vacation leave, notifying the Secretary of State of corporation license tax nonfilers and delinquent filers, and Board of Review meetings. The department's response begins on page B-3.

We thank the department's director and staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

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	C.A. Daw, Chief Legal Counsel
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	Margaret Kauska, Information Technology and Processing
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Report Summary

Department of Revenue

This report documents issues noted during our financial-compliance audit of the Department of Revenue (department) for the two fiscal years ended June 30, 2008. The seven recommendations in this report discuss unrecorded liabilities, accounting misclassifications, the Internal Service Fund rate, unauthorized investments, excess vacation leave, notifying the Secretary of State of corporation license tax nonfilers and delinquent filers, and Board of Review meetings. The prior report contained seven recommendations, of which four have been implemented and three partially implemented.

We issued a qualified opinion on the department's financial schedules presented in this report. The opinion on page A-3 discusses misclassifications between current and prior year revenues. This means the reader should use caution when analyzing the presented financial information and the supporting data on the primary accounting records.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1 6

We recommend the department accrue liabilities for metal mines license tax allocations to counties in accordance with state law and accounting policy.

Department response: Concur B-3

Recommendation #2 9

We recommend the department properly classify current and prior year revenue activity, liability and fund balance accounts, and fiscal year for budgetary transactions in accordance with state law and accounting policy.

Department response: Partially concur B-3

Recommendation #3 10

We recommend the department analyze and adjust its delinquent account collection rate as often as necessary to be commensurate with costs, in accordance with state law.

Department response: Concur B-6

Recommendation #4 10

We recommend the department stop investing undistributed combined oil and gas tax revenues.

Department response: Concur B-6

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Department of Revenue (department) for the two fiscal years ended June 30, 2008. The objectives of our audit were to:

1. Determine if the department complied with selected state and federal laws and regulations during the audit period.
2. Obtain an understanding of the department's control systems to the extent necessary to support our audit of the department's financial schedules and, if appropriate, make recommendations for improvements in management and internal controls of the department.
3. Determine the implementation status of prior audit recommendations.
4. Determine if the department's financial schedules fairly present the results of its operations for each of the fiscal years ended June 30, 2007, and 2008, and if the department's Schedule of Expenditures of Federal Awards for each of these fiscal years was fairly presented in relation to the financial schedules.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the costs, if significant, of implementing the recommendations contained in this report. Issues deemed not to have significant effect on department operations have been discussed with management, but are not included in this report.

As required by section 17-8-101(6), MCA, we analyzed the fees and charges for services and the fund equity of the department's Internal Service Fund, which is used to provide bad debt collection services to state agencies. The statute requires fees and charges for services deposited in the Internal Service Fund be based upon commensurate costs. Based on our review (see page 9), we determined the rates were not commensurate with costs for the activity in the Internal Service Fund for fiscal years 2006-07 and 2007-08, and the fund equity at June 30, 2007, and 2008, was excessive.

Department Organization and Functions

The department collects revenue from and enforces regulations for over 30 state taxes and fees. Taxes collected include individual income, corporation, natural resource, accommodation, property, alcohol, and tobacco. The department also regulates the sale and distribution of alcoholic beverages in the state.

As of June 30, 2008, the department was composed of 647.78 FTE in five divisions, with overall agency direction and management coordinated from the Director's Office.

The **Business and Income Taxes Division** (136.75 FTE) oversees audits and verifies compliance with Montana tax law for all state taxes, oversees state revenue collection activity, and completes appraisals and assessments of industrial and centrally assessed property.

The **Citizen Services and Resource Management Division** (25 FTE) provides service to Montana citizens, businesses, and nonresident taxpayers through a call center, one-stop licensing, forms design, and other taxpayer services. The division also provides service and support to the department in the areas of accounting, purchasing, and facilities and asset management. The division also seeks to return unclaimed property, lost money, and other properties to its rightful owners.

The **Information Technology and Processing Division** (99.45 FTE) provides application development and support services, as well as network services in the areas of data, desktop, information security, and help desk support. The division also processes tax returns and payments for the department and for state agency partners.

The **Liquor Control Division** (28.50 FTE) administers the state's Alcoholic Beverage Code, which governs the control, sale, and distribution of alcoholic beverages. The division includes liquor distribution and liquor licensing.

The **Property Assessment Division** (310.10 FTE) is responsible for the valuation and assessment of real and personal property throughout the state for property tax purposes. The division is comprised of a central office located in Helena and six regional areas. There is a local department office in each county seat within the regional areas.

The **Director's Office** (47.98 FTE) supports the agency's director and is composed of four work units. The basic function for each unit is:

- **Legal Services** supervises the overall legal efforts of the department, which includes rules, policies, bankruptcy, the disclosure officer, and the Office of Dispute Resolution.
- **Tax Policy and Research** is responsible for the preparation of legislative fiscal notes that affect revenue, the analysis of legislative proposals affecting the department, and department economic data and tax compliance analysis.
- **Human Resources** manages the personnel activities of the department. The office includes three units: Human Resources, Payroll and Benefits, and Education and Training.
- **Executive Office** includes budget analyst, public relations, and administrative support.

Advisory Councils, Boards, and Memberships

An **Advisory Council for Multi-State Tax Compact** was authorized by section 2-15-1311, MCA, to act in an advisory capacity to the multi-state tax commission member for Montana for the purpose of complying with Article VI, section 1(B) of the compact. That member is the department director or the director's designee. This council has no rulemaking or rule adjudicating authority.

The **Agricultural Land Valuation Advisory Council** was created by section 15-7-201(7), MCA, to advise the department concerning the valuation of agricultural property. This council must include a member from the Montana State University-Bozeman, College of Agriculture, staff. This advisory council is not a policymaking body and has no rulemaking authority.

The **Board of Review** established by the Montana Small Business Licensing Coordination Act in section 30-16-302, MCA, oversees the department's one-stop licensing program, and is attached to the department for administrative purposes only. The board has separate rulemaking authority under section 30-16-104, MCA.

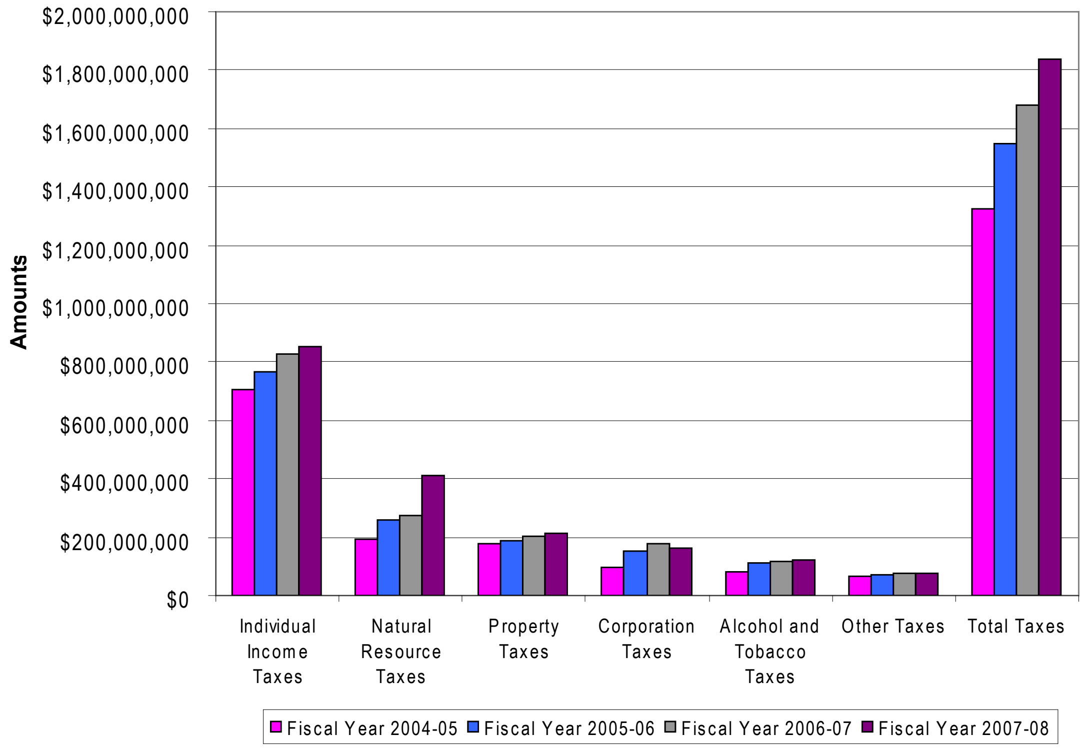
The department is a member of the Multistate Tax Commission, the Federation of Tax Administrators, the Western States Association of Tax Administrators, the National Alcohol and Beverage Control Association, and the National Association of Unclaimed Property Administrators. The department also participates in state interagency organizations including: the Information Technology Board, the Electronic Government Advisory Council, the Information Technology Managers Council, and the Land Information Advisory Council.

Tax Revenues

Tax revenues represented 85 percent of total revenues recorded on the state's accounting system for the department in fiscal years 2005-06, 2006-07, and 2007-08. Tax revenues by type, as recorded by the department on the state's accounting system for fiscal years 2004-05, 2005-06, 2006-07, and 2007-08 are illustrated in Figure 1.

Figure 1

Department of Revenue Tax Revenues by Type
For Fiscal Years 2004-05, 2005-06, 2006-07, and 2007-08



Source: Compiled by the Legislative Audit Division from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS).

Prior Audit Recommendations

The previous financial-compliance audit report of the department for the two fiscal years ended June 30, 2006, contained seven recommendations. Of those, the department implemented four, and partially implemented three, recommendations. Issues related to two of the three partially implemented recommendations, regarding the Internal Service Fund rate and notifying the Secretary of State of corporation license tax nonfilers and delinquent filers, are discussed on pages 9 and 12, respectively. The third partially implemented recommendation concerns a requirement in section 15-36-313(1), MCA, for the department to "immediately after the time has expired" for the filing of the oil and natural gas production tax return, estimate the taxes due for those operators that have not filed a return. The department sought legislation, which did not pass, to address this issue during the 2007 Legislative Session. The department should continue to seek statutory resolution of this issue.

Chapter II – Findings and Recommendations

Accounting Issues

Section 17-1-102(4), MCA, requires the department to input all necessary transactions on the state's accounting system before the end of the fiscal year to present the receipt, use, and disposition of all money for which it is accountable in accordance with generally accepted accounting principles. To facilitate agencies' compliance with this law, the Department of Administration has issued accounting policies and procedures in Montana Operations Manual (MOM) Volume II, as well as provided instructions for certain types of transactions in Management Memos.

During the audit we reviewed various aspects of the department's controls for ensuring compliance with this state law and accounting policies and procedures. We performed tests of transactions and analyzed financial activity recorded on the department's accounting records to determine whether the department complied with state law and accounting policy. The following sections discuss instances where liabilities were not recorded on the department's accounting records and accounting classifications could be improved.

Unrecorded Allocation Liabilities

Prior to June 30, 2008, the department did not accrue its obligation to allocate approximately $2,000,000 in metal mines license tax revenues.

State law requires the department to allocate a portion of the metal mines license tax revenue to counties, so recording this revenue creates an obligation to make the allocation. Prior to June 30, 2008, the department accrued estimated metal mines license tax revenue receivable, but not the related expenditure and obligation to allocate this revenue to counties. The department recorded the allocation expenditure in the subsequent year when the allocation was paid. To comply with state accounting law and MOM section 2-8145, that obligation should have been accrued in the State Special Revenue Fund on the state's accounting system each June 30, rather than recording the expenditure when the allocation was made.

The department accrued the obligation at June 30, 2008, after we brought this issue to their attention. By not accruing the obligation at June 30, 2007, the department understated the Due to Local Governments liability and overstated Fund Balance in the State Special Revenue Fund at June 30, 2007, by approximately $2,000,000. Also, expenditures that should have been recorded in fiscal year 2006-07 were recorded in fiscal year 2007-08, overstating expenditures in the State Special Revenue Fund for fiscal year 2007-08 by approximately $2,000,000. Department personnel accrued similar allocation obligations for other taxes during the audit period and told us not accruing the allocation of metal mines license taxes was an oversight.

Recommendation #1

We recommend the department accrue liabilities for metal mines license tax allocations to counties in accordance with state law and accounting policy.

Accounting Classifications

The department could improve accounting classifications for revenue, liability, fund balance, and budgetary account transactions each fiscal year.

During the current and prior audits, we have found the department has procedures for ensuring its activity and account balances are recorded consistently with prior years' practices. During this audit, we took an in-depth look at the department's accrual, accrual reversal, and subsequent collection and payment of amounts accrued to determine if the related activity and balances were appropriately and consistently recorded and if they were recorded in compliance with state accounting policy. As a result of these and other procedures, we identified four areas where the department could improve its accounting classifications when coding transactions.

Prior Year Revenue Adjustments

MOM section 2-0250.10, regarding correction of prior year errors, requires an agency that becomes aware that a necessary transaction was not recorded in the prior year or that a transaction was recorded in error, to record a correcting prior year adjustment entry in the state's accounting system. The department recorded Prior Year Revenues & Transfers-In Adjustments netting to a total of $77,618,779 and $74,692,514 in fiscal years 2006-07 and 2007-08, respectively.

We found most of this prior year adjustment activity was related to the accounting treatment of tax receivable and refund liability accruals in the General Fund, liquor sales accruals in the Enterprise Fund, and subsequent collection or payment of the accruals in the year following the accrual. Several state accounting policies address when revenue should be accrued on the accounting records. One policy shows example transactions regarding the recognition of prior year revenue adjustments for the difference between the amount accrued in the prior year and the amount subsequently collected. Consistency in application of accounting principles would require agencies use the same technique for similar accruals. We analyzed the department's revenue activity related to accruals by accrual type and transaction type and identified inconsistencies between accrual types and noncompliance with state accounting policy, as shown in the table and as discussed below.

Table 1
Revenue Classifications for Certain Department of Revenue Accrual Types

	Revenue Classifications by Transaction Type and Year		
Accrual Type	**Initial Accrual In Year 1**	**Accrual Reversal In Year 2**	**Collection/ Payment In Year 2**
Tax Receivable Accruals	Current	Prior	Prior
Tax Refund Payable Accruals	Current	Prior	Current
Liquor Sales Accruals	Current	Prior	Current

Source: Compiled by the Legislative Audit Division.

We found the initial accruals recorded at the end of fiscal years 2006-07 and 2007-08 were recorded in accordance with state accounting policy (MOM chapter 2-1100) and the accrual amounts were supported and reasonable. We also found the accrual reversal transactions recorded in fiscal years 2006-07 and 2007-08 were recorded consistently. For tax receivable accruals, the department followed the example transactions provided in state accounting policy for such accruals and classified collections in the subsequent year as prior year revenue. As a result, the prior year revenue adjustments related to this activity reflected the difference between the estimated amount accrued and the amount collected in the year following accrual.

For tax refunds and liquor sales, we found the department recorded current year revenue again in the subsequent year when the tax refunds were paid and liquor receivables were collected. Since the accruals were reversed against prior year revenue adjustments in the year following the accrual, the prior year adjustments related to this activity represented the reversal, instead of the difference between the amount accrued and the amount paid or collected in the year following accrual. As a result, Prior Year Revenues & Transfers-In Adjustments are overstated and Actual Budgeted Revenues and Transfers-In are understated on the state's accounting records by a net total of $72,531,156 and $78,451,044 for fiscal years 2006-07 and 2007-08, respectively. These misclassifications between current and prior year revenues do not affect the state's annual financial report, which distinguishes between prior and current year amounts only for errors in the application of generally accepted accounting principles in prior years.

Department personnel said it is difficult to determine how much of the refunds issued based on current year tax returns are attributable to the prior year's accrual estimate. Department personnel indicated collections for liquor revenues accrued the previous year were not offset against the accrued amounts, as is done for tax revenues, because the liquor accruals are based on invoiced receivables instead of estimated receivables. The department could record adjustments to allocate refunds between fiscal years based on an estimate and could adjust liquor collections in a manner similar to the adjustments it makes for tax collections accrued in the prior year.

Liability Accounts

Proper use of liability accounts facilitates proper presentation of the state's liabilities in the state's annual financial statements. State accounting policy (MOM chapter 2-0300) defines the liability accounts Due to Local Governments and Accounts Payable as amounts owed to local governments and as amounts owed on account to private persons or organizations for goods or services received, respectively. The department accrued $51,309,368 of natural resource tax distributions to local governments as an Accounts Payable. As a result, Accounts Payable is overstated by $51,309,368 and Due to Local Governments is understated by the same amount at June 30, 2007. Department staff stated they had always recorded this liability as an Accounts Payable. At June 30, 2008, department personnel properly accrued the liability for these distributions in the Due to Local Governments account.

Fund Balance Accounts

Proper use of fund balance accounts facilitates presentation of the state's fund balances in the state's annual financial statements in accordance with generally accepted accounting principles. State accounting policy (MOM section 2-5020.20) requires fund balance in governmental funds be reserved by the amount of long-term advances to other funds to indicate the portion of fund balance not available for future appropriation. The department's Coal Severance Tax Permanent Funds had made long-term advances to other funds which decreased during the audit period. However, the department had not adjusted the reserved portion of fund balance to match the amount of outstanding advances since June 30, 2005, until we discussed the issue with department personnel prior to the close of fiscal year 2007-08. As a result, the reserved portion of fund balance was overstated and the unreserved portion was understated by $10,927,177 at June 30, 2006, and $30,275,806 at June 30, 2007. Department personnel made a $41,701,582 adjustment at fiscal year-end 2007-08 to bring the reserved fund balance to the appropriate level.

Budgetary Transactions

Generally accepted accounting principles require that budgets be recorded in the fiscal year for which they were adopted to facilitate comparison of actual to budgeted results.

The transaction fiscal year is determined by the transaction date established when the transaction is coded. Department personnel recorded a transaction intended to increase a statutory appropriation for fiscal year 2006-07 by $4,000,000 in fiscal year 2005-06 on the same accounting document as a similar transaction for fiscal year 2005-06. They did not realize the $4,000,000 increase for fiscal year 2006-07 was recorded in the wrong fiscal year because they review budgetary activity based on program year and budget year, which were coded properly.

Department personnel also created a revenue estimate for $8,200,000 for the fiscal year 2006-07 liquor profits transfer, although an estimate had already been recorded for that transfer. Although there is an expectation of one revenue estimate for each revenue source, they indicated the second estimate was needed because the original estimate was not coded properly. The second estimate was recorded in fiscal year 2007-08 and, after we brought it to the department's attention, was reversed.

Recommendation #2

We recommend the department properly classify current and prior year revenue activity, liability and fund balance accounts, and fiscal year for budgetary transactions in accordance with state law and accounting policy.

Internal Service Fund Rate

The department's debt collection program fee revenues were not commensurate with costs for fiscal years 2006-07 and 2007-08, resulting in an increase to the excessive fund equity disclosed in the prior audit.

The department has one Internal Service Fund which is used to account for its debt collection program. Section 17-7-123(1)(f)(ii), MCA, states "...Fees and charges in a biennium may not exceed the level approved by the legislature in the general appropriations act effective for that biennium." The legislature approved a maximum delinquent account collection fee rate of ten percent of the amounts collected for the 2007 biennium and five percent for the 2009 biennium. Section 17-8-101(6), MCA, requires Internal Service Fund fees be commensurate with costs. Section 17-4-106(2), MCA, requires the delinquent account collection fees deposited in excess of the amount appropriated for operation of the debt collection program be carried forward into the next fiscal year and used to reduce the delinquent account collection fee rate.

Department personnel analyze the Internal Service Fund rate once every two years in September preceding the biennial legislative sessions. When department personnel analyzed the rate in September 2006, they calculated a rate of 4.10 to 4.15 percent, which they rounded to five percent. They chose to leave the rates for fiscal years 2006-07 and 2007-08 at the maximum rate approved by the legislature, although nothing prohibits the department from reducing the rate. As a result of using the maximum rates, correction of prior year errors in fiscal year 2006-07, collections that exceeded estimates by 50 percent in fiscal year 2007-08, and other variances from estimates during the audit period, the fund equity in the Internal Service Fund increased from $148,404 at June 30, 2006, to $246,382 at June 30, 2008. The June 30, 2008, fund equity is sufficient to fund expenditures appropriate for its business cycle for about one and a half years. Because collections and operating expenses can vary from biennial estimates, the department should analyze and adjust the Internal Service Fund rate as often as necessary to comply with section 17-8-101(6), MCA.

Recommendation #3

We recommend the department analyze and adjust its delinquent account collection rate as often as necessary to be commensurate with costs, in accordance with state law.

Unauthorized Investments

The department invests combined oil and gas tax revenue in the Board of Investments' Short-Term Investment Pool (STIP) until the funds are distributed, although the department has no authority in law to do so.

Section 17-6-202(2), MCA, requires all money be invested in the Treasurer's Fund, unless other laws or legal documents specifically require otherwise. Because the department has no authority to invest undistributed combined oil and gas tax revenue, these funds should be included in the Treasurer's Fund. When we asked department personnel for documentation of their authority to invest these funds, they discovered their authority in section 15-36-324(2), MCA, had been repealed in April 2003. The department should stop investing funds that it has no authority to invest.

Recommendation #4

We recommend the department stop investing undistributed combined oil and gas tax revenues.

Excess Vacation Leave

Due to a calculation error, seven department employees accumulated more vacation leave than state law permits.

Section 2-18-617(1), MCA, limits the amount of vacation leave an employee can accumulate and carry forward to twice the amount an employee earns in a calendar year. Vacation leave accumulated above this amount is considered excess and must be used by the employee within the first 90 days of the calendar year, unless an employee's written request for such leave is denied by the employing agency. If the employing agency denies the request, the excess vacation leave is not forfeited if used before the end of that calendar year. State law makes it the employing agency's responsibility to provide reasonable opportunity for an employee to use, rather than forfeit, excess vacation leave.

Department personnel have procedures to calculate the amount of excess vacation leave that needs to be taken or forfeited, but the procedures they followed for calculating excess vacation leave were flawed and the resources they used from the state's accounting system were designed for other purposes. The department's excess leave calculation understated the amount of excess vacation leave. As a result, seven employees had excess vacation leave balances at the end of the first pay period in calendar year 2008 that should have been forfeited December 31, 2007, but had not been forfeited as of May 27, 2008. These employees had accumulated excess vacation leave from prior years ranging from 3.62 to 79.82 hours, with a total value of $9,013 at January 4, 2008. Not forfeiting the excess vacation leave hours in accordance with state law increases the department's liability for compensated absences.

Recommendation #5

We recommend the department revise procedures to ensure excess vacation leave is properly calculated and used by employees or forfeited in accordance with state law.

Tax Administration Issues

Section 15-1-201(1)(a), MCA, provides the department has general supervision over the administration of the assessment and tax laws of the state, except for gasoline and vehicle fuels taxes. During the course of our audit work, including follow-up on prior audit recommendations, we identified an area where we believe the department could improve the administration of the tax laws, as discussed below. Our office also recommended during the performance audit "Improving Montana's Opencut Mine Permitting Process" (08P-04), that the Department of Environmental Quality coordinate data-sharing needs with the Department of Revenue to help ensure identification of all opencut mining operators required to pay the Resource Indemnity and Groundwater Assessment Tax.

Notification of Nonfilers and Delinquent Filers

The department does not have adequate procedures to notify the Secretary of State of all corporation license tax nonfilers and delinquent filers, as required by section 15-31-523, MCA.

If a corporate license tax is not paid or if a return is not filed 11 months after the date of delinquency, section 15-31-523, MCA, requires the department to transmit the name of the corporation to the Secretary of State so the public can be notified the corporate powers, rights, and privileges of domestic corporations are suspended and the rights of foreign corporations to do intrastate business in this state are forfeited. If any domestic corporation fails for five consecutive years to either file a return or to pay the corporation license tax, this statute requires the department to notify the corporation by mail that the corporation will become dissolved if it fails to file all delinquent reports and pay all delinquent corporation license taxes within 60 days. If the corporation does not file all delinquent reports and pay all delinquent corporation license taxes, the statute requires the department to certify this fact to the Secretary of State, the corporation be dissolved, and the public notified of the corporation's dissolution.

As discussed in the prior audit, the department does not notify the Secretary of State when a corporation does not file or is delinquent in filing, unless department personnel know the corporation is currently operating in Montana and refuses to file a corporation license tax return. Department personnel do not check with the Secretary of State or its website to see whether the corporation is active. Department personnel indicated that the benefit of trying to comply with this statute is minimal, as past history has shown most corporations that do not file returns have already voluntarily dissolved or are no longer active. They also were concerned about the potential risk of suspending a corporation that had filed and the related cost of time to correct such an error. Department personnel estimated the cost to the department of complying with this law is about $13,000 and the cost to the Secretary of State is about $24,000 for computer system enhancements.

Recommendation #6

We recommend the department report corporation license tax nonfilers and delinquent filers to the Secretary of State as required by state law.

Board of Review Meetings

The Board of Review does not meet quarterly, as required by section 30-16-302(3), MCA.

The legislature established a Board of Review in section 30-16-302, MCA, to provide policy direction to the Department of Revenue in designing and recommending to the legislature implementation of a plan for a business registration and licensing system and in the establishment and operation of that system, the One-Stop Licensing Program. State law requires the board include the directors of the Departments of Agriculture, Labor and Industry, Environmental Quality, Livestock, Revenue, Justice, and Public Health and Human Services; a member appointed by the President of the Senate; and a member appointed by the Speaker of the House. If an agency that is not a member of the Board of Review requests inclusion in the streamlined registration and licensing plan as provided in state law, that agency's director must be appointed to the board by the Governor. The Governor must appoint a presiding officer from among the board members.

Section 30-16-302(3), MCA, requires the board to meet at the call of the presiding officer, who is the director of the Department of Revenue, at least once each calendar quarter. The board met twice in each fiscal year 2004-05, 2005-06, and 2006-07 and three times in fiscal year 2007-08. One-Stop Licensing Program personnel told us the meeting dates are established after taking into consideration the board members' schedules and whether current issues warrant a meeting.

Recommendation #7

We recommend the department director call meetings of the Board of Review as required by state law.

Independent Auditor's Report and Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor
Monica Huyg, Legal Counsel

Deputy Legislative Auditors
James Gillett
Angie Grove

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedule of Changes in Fund Balances & Property Held in Trust, Schedule of Total Revenues & Transfers-In, and Schedule of Total Expenditures & Transfers-Out of the Department of Revenue for each of the fiscal years ended June 30, 2008, and June 30, 2007. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, these financial schedules are prepared on the basis of Montana state accounting policy, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities, and cash flows.

The department reversed its fiscal year 2006-07 and 2005-06 accruals of individual income and corporation tax revenue refunds and liquor revenues as prior year adjustments and recorded the related payments and collections as current year revenue in the next fiscal year. As a result, the following over (under) statements occurred on the Schedule of Changes in Fund Balances & Property Held in Trust and the Schedule of Total Revenues & Transfers-In for fiscal years 2007-08 and 2006-07.

	Fiscal Year 2007-08		Fiscal Year 2006-07	
Account	**General Fund**	**Enterprise Fund**	**General Fund**	**Enterprise Fund**
Prior Year Revenues & Transfers-In Adjustments	$94,523,801	$(16,072,757)	$ 86,760,688	$(14,229,532)
Actual Budgeted Revenues & Transfers-In	$(94,523,801)	$16,072,757	$(86,760,688)	$4,229,532
Budgeted Revenues & Transfers-In Over (Under) Estimated Class	$(94,523,801)	$16,072,757	$(86,760,688)	$14,229,532
Taxes	$(94,523,801)		$(86,760,688)	
Sale of Documents, Merchandise and Property		$16,072,757		$14,229,532

In our opinion, except for the effects of the matters discussed in the preceding paragraph, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Department of Revenue for each of the fiscal years ended June 30, 2008, and June 30, 2007, in conformity with the basis of accounting described in note l.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

November 21, 2008

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund
FUND BALANCE: July 1, 2007	$ 19,834,210	$ 34,964,839	$ 1	$ 93,270	$ 1,242,874	$ 2,931,775	$ 242,304	$ 0	$ 1,028,073	$ 865,652,130
PROPERTY HELD IN TRUST: July 1, 2007								$ 173,488		
ADDITIONS										
Budgeted Revenues & Transfers-In	1,510,475,724	356,343,523	210,395		7,515,457	89,581,519	95,730			94,119,458
Nonbudgeted Revenues & Transfers-In	619,775	1,369,377		703,709		16,084,113			2,029,923	2,844,237
Prior Year Revenues & Transfers-In Adjustments	93,733,678	(1,646,338)		(5,426)	(69,221)	(16,070,974)			(24,074)	(1,225,131)
Direct Entries to Fund Balance	(1,338,320,765)	(179,505,286)		(692,939)	(7,386,236)	(978,801)				(858,400)
Additions to Property Held in Trust								3,784,616		
Total Additions	266,508,412	176,561,276	210,395	5,344	60,000	88,615,857	95,730	3,784,616	2,005,849	94,880,164
REDUCTIONS										
Budgeted Expenditures & Transfers-Out	235,238,834	171,423,831	194,193			88,413,376	88,601			
Nonbudgeted Expenditures & Transfers-Out	1,380,647	27,260				180,993	3,050		1,837,846	67,254,454
Prior Year Expenditures & Transfers-Out Adjustments	(38,261)	1,160,627				114			(224)	(1,289,124)
Reductions in Property Held in Trust								3,814,727		
Total Reductions	236,581,220	172,611,718	194,193	0	0	88,594,483	91,651	3,814,727	1,837,622	65,965,330
FUND BALANCE: June 30, 2008	$ 49,761,402	$ 38,914,397	$ 16,203	$ 98,614	$ 1,302,874	$ 2,953,149	$ 246,383	$ 0	$ 1,196,300	$ 894,566,964
PROPERTY HELD IN TRUST: June 30, 2008								$ 143,377		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund
FUND BALANCE: July 1, 2006	$ 15,603,777	$ 29,982,905	$ (32)	$ 85,076	$ 1,095,236	$ 7,892,775	$ 148,404	$ 0	$ 852,925	$ 839,322,789
PROPERTY HELD IN TRUST: July 1, 2006								$ 252,860		
ADDITIONS										
Budgeted Revenues & Transfers-In	1,414,003,874	273,712,784	228,126		6,956,633	82,999,469	140,365			96,787,451
Nonbudgeted Revenues & Transfers-In	1,201,311	6,521,600		651,002		14,246,088		2,100	2,613,194	1,242,745
Prior Year Revenues & Transfers-In Adjustments	90,985,838	1,904,099		22,980	(46,954)	(14,238,615)		(2,100)		(1,006,469)
Direct Entries to Fund Balance	(1,368,448,276)	(160,805,118)		(665,788)	(6,762,041)	(1,281,128)				(969,729)
Additions to Property Held in Trust								2,461,267		
Total Additions	137,742,747	121,333,365	228,126	8,194	147,638	81,725,814	140,365	2,461,267	2,613,194	96,053,998
REDUCTIONS										
Budgeted Expenditures & Transfers-Out	133,689,766	113,362,080	228,093			80,229,328	82,409			
Nonbudgeted Expenditures & Transfers-Out	(5,245)	448,869				1,912,675	718		2,438,047	69,724,657
Prior Year Expenditures & Transfers-Out Adjustments	(172,207)	2,540,482				4,544,811	(36,662)			
Reductions in Property Held in Trust								2,540,639		
Total Reductions	133,512,314	116,351,431	228,093	0	0	86,686,814	46,465	2,540,639	2,438,047	69,724,657
FUND BALANCE: June 30, 2007	$ 19,834,210	$ 34,964,839	$ 1	$ 93,270	$ 1,242,874	$ 2,931,775	$ 242,304	$ 0	$ 1,028,072	$ 865,652,130
PROPERTY HELD IN TRUST: June 30, 2007								$ 173,488		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS										
Licenses and Permits	$ 5,585,404	$ 27,744,026				$ 2,956,100				$ 36,285,530
Taxes	1,503,808,267	281,197,400		$ 698,283	$ 7,446,236	20,333,300			$ 23,230,833	1,836,714,319
Charges for Services	499,427	14,523,190				4,110	$ 95,730			15,122,457
Investment Earnings	(304,134)							$ 37,339	49,472,274	49,205,479
Fines, Forfeits and Settlements						146,220				146,220
Sale of Documents, Merchandise and Property						66,141,101				66,141,101
Miscellaneous	5,220	29,520				13,827				48,567
Grants, Contracts, Donations and Abandonments	3,653,928	314,155						1,968,510		5,936,593
Other Financing Sources	54,537,132	19,914,827							23,035,457	97,487,416
Federal	37,030,331	12,343,444	$ 210,395							49,584,170
Federal Indirect Cost Recoveries	13,602									13,602
Total Revenues & Transfers-In	1,604,829,177	356,066,562	210,395	698,283	7,446,236	89,594,658	95,730	2,005,849	95,738,564	2,156,685,454
Less: Nonbudgeted Revenues & Transfers-In	619,775	1,369,377		703,709		16,084,113		2,029,923	2,844,237	23,651,134
Prior Year Revenues & Transfers-In Adjustments	93,733,678	(1,646,338)		(5,426)	(69,221)	(16,070,974)		(24,074)	(1,225,131)	74,692,514
Actual Budgeted Revenues & Transfers-In	1,510,475,724	356,343,523	210,395	0	7,515,457	89,581,519	95,730	0	94,119,458	2,058,341,806
Estimated Revenues & Transfers-In	1,494,045,265	345,808,624	413,530		6,481,000	106,725,497	53,500		97,800,000	2,051,327,416
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 16,430,459	$ 10,534,899	$ (203,135)	$ 0	$ 1,034,457	$ (17,143,978)	$ 42,230	$ 0	$ (3,680,542)	$ 7,014,390
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS										
Licenses and Permits	$ (671,902)	$ (619,644)				$ 913,561				$ (377,985)
Taxes	27,347,655	9,410,020			$ 1,034,457	(611,666)			$ 1,747,241	38,927,707
Charges for Services	14,603	1,587,891	$ (132,000)			4,110	$ 42,230			1,516,834
Investment Earnings	(304,135)	(1,950,869)							(161,628)	(2,416,632)
Fines, Forfeits and Settlements						9,507				9,507
Sale of Documents, Merchandise and Property						(17,459,490)				(17,459,490)
Miscellaneous	(335,000)									(335,000)
Grants, Contracts, Donations and Abandonments	1,742,011	30,031								1,772,042
Other Financing Sources	(16,039,332)	(1,052,050)							(5,266,155)	(22,357,537)
Federal	4,694,559	3,129,520	(71,135)							7,752,944
Federal Indirect Cost Recoveries	(18,000)									(18,000)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ 16,430,459	$ 10,534,899	$ (203,135)	$ 0	$ 1,034,457	$ (17,143,978)	$ 42,230	$ 0	$ (3,680,542)	$ 7,014,390

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS											
Licenses and Permits	$ 5,720,544	$ 23,841,168				$ 1,679,551					$ 31,241,263
Taxes	1,414,698,998	220,139,647		$ 673,982	$ 6,909,679	19,039,498				$ 20,952,367	1,682,414,171
Charges for Services	217,451	8,245,717	$ 92,400			3,475	$ 140,365				8,699,408
Investment Earnings	(1,543)								$ 37,912	51,401,945	51,438,314
Fines, Forfeits and Settlements						131,770					131,770
Sale of Documents, Merchandise and Property						62,136,010					62,136,010
Miscellaneous	463	5,000				16,638					22,101
Grants, Contracts, Donations and Abandonments	1,743,673	300,663							2,575,282		4,619,618
Other Financing Sources	56,132,202	20,382,596								24,669,415	101,184,213
Federal	27,671,076	9,223,692	135,726								37,030,494
Federal Indirect Cost Recoveries	8,159										8,159
Total Revenues & Transfers-In	1,506,191,023	282,138,483	228,126	673,982	6,909,679	83,006,942	140,365	0	2,613,194	97,023,727	1,978,925,521
Less: Nonbudgeted Revenues & Transfers-In	1,201,311	6,521,600		651,002		14,246,088		$ 2,100	2,613,194	1,242,745	26,478,040
Prior Year Revenues & Transfers-In Adjustments	90,985,838	1,904,099		22,980	(46,954)	(14,238,615)		(2,100)		(1,006,469)	77,618,779
Actual Budgeted Revenues & Transfers-In	1,414,003,874	273,712,784	228,126	0	6,956,633	82,999,469	140,365	0	0	96,787,451	1,874,828,702
Estimated Revenues & Transfers-In	1,437,669,443	296,864,097	409,609		5,704,520	88,128,211	145,000			86,020,002	1,914,940,882
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (23,665,569)	$ (23,151,313)	$ (181,483)	$ 0	$ 1,252,113	$ (5,128,742)	$ (4,635)	$ 0	$ 0	$ 10,767,449	$ (40,112,180)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS											
Licenses and Permits	$ (98,208)	$ 6,327,109				$ (101,715)					$ 6,127,186
Taxes	(22,005,635)	(36,109,843)			$ 1,252,113	1,414,973				$ 6,153,783	(49,294,609)
Charges for Services	8,105	1,016,005				(1,139)	$ (4,635)				1,018,336
Investment Earnings	(1,544)	(1,250,000)								5,092,385	3,840,841
Fines, Forfeits and Settlements						(2,265)					(2,265)
Sale of Documents, Merchandise and Property						(6,433,948)					(6,433,948)
Miscellaneous						(4,648)					(4,648)
Grants, Contracts, Donations and Abandonments	(1,949,674)	(135,354)									(2,085,028)
Other Financing Sources	840,668	(2,406,135)								(478,719)	(2,044,186)
Federal	(459,281)	9,406,905	$ (181,483)								8,766,141
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (23,665,569)	$ (23,151,313)	$ (181,483)	$ 0	$ 1,252,113	$ (5,128,742)	$ (4,635)	$ 0	$ 0	$ 10,767,449	$ (40,112,180)

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DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	Business & Income Taxes Division	Citizen Services & Resource Management Division	Customer Service Center	Director's Office	Information Technology & Processing Division	Liquor Control Division	Property Assessment Division	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT								
Personal Services								
Salaries	$ 5,682,961	$ 967,883		$ 2,477,092	$ 2,737,538	$ 1,025,521	$ 10,752,935	$ 23,643,930
Hourly Wages							(295)	(295)
Employee Benefits	1,908,494	336,840		724,746	941,526	366,482	3,855,974	8,134,062
Personal Services-Other	4,063		$ (5,280)			49,754		48,537
Total	7,595,518	1,304,723	(5,280)	3,201,838	3,679,064	1,441,757	14,608,614	31,826,234
Operating Expenses								
Other Services	881,143	474,911		1,699,059	7,285,155	248,909	1,522,249	12,111,426
Supplies & Materials	387,349	39,797		197,056	882,301	73,651	379,147	1,959,301
Communications	114,178	135,225		42,826	905,593	38,049	284,524	1,520,395
Travel	310,826	6,626		143,180	34,051	25,672	320,238	840,593
Rent	201,937	24,518		118,839	201,349	405	2,008,312	2,555,360
Utilities		1,721			348	89,206	1,703	92,978
Repair & Maintenance	73,061	7,292		275,109	1,900,462	49,477	36,727	2,342,128
Other Expenses	244,443	18,730		49,531	94,633,382	172,454	45,523	95,164,063
Goods Purchased For Resale						55,698,205		55,698,205
Total	2,212,937	708,820		2,525,600	105,842,641	56,396,028	4,598,423	172,284,449
Equipment & Intangible Assets								
Equipment					181,220	(59,553)	8,720	130,387
Total					181,220	(59,553)	8,720	130,387
Local Assistance								
From State Sources	8,643,139	384,155		90,317,843			163,839,278	263,184,415
Total	8,643,139	384,155		90,317,843			163,839,278	263,184,415
Benefits & Claims								
OPEB Expenses	6,102					124,126		130,228
Total	6,102					124,126		130,228
From Other Sources								
Distrib from Priv Purp Trusts		1,818,988						1,818,988
Total		1,818,988						1,818,988
Transfers								
Accounting Entity Transfers						30,517,552	65,983,964	96,501,516
Total						30,517,552	65,983,964	96,501,516
Total Expenditures & Transfers-Out	$ 18,457,696	$ 4,216,686	$ (5,280)	$ 96,045,281	$ 109,702,925	$ 88,419,910	$ 249,038,999	$ 565,876,217
EXPENDITURES & TRANSFERS-OUT BY FUND								
General Fund	$ 9,119,293	$ 1,859,004		$ 95,874,683	$ 109,471,528		$ 20,256,712	$ 236,581,220
State Special Revenue Fund	9,047,879	492,455		84,279	161,522	$ 27,260	162,798,323	172,611,718
Federal Special Revenue Fund	193,593			600				194,193
Enterprise Fund		46,239		85,719	69,875	88,392,650		88,594,483
Internal Service Fund	96,931		$ (5,280)					91,651
Private Purpose Trust Fund		1,818,988					18,634	1,837,622
Permanent Fund							65,965,330	65,965,330
Total Expenditures & Transfers-Out	18,457,696	4,216,686	(5,280)	96,045,281	109,702,925	88,419,910	249,038,999	565,876,217
Less: Nonbudgeted Expenditures & Transfers-Out	10,165	1,819,213	(5,280)	1,378,811		208,253	67,273,088	70,684,250
Prior Year Expenditures & Transfers-Out Adjustments	142,396	(224)		(37,425)	250	114	(271,979)	(166,868)
Actual Budgeted Expenditures & Transfers-Out	18,305,135	2,397,697	0	94,703,895	109,702,675	88,211,543	182,037,890	495,358,835
Budget Authority	19,632,391	2,475,003		94,968,626	114,488,086	105,071,680	189,024,828	525,660,614
Unspent Budget Authority	$ 1,327,256	$ 77,306	$ 0	$ 264,731	$ 4,785,411	$ 16,860,137	$ 6,986,938	$ 30,301,779
UNSPENT BUDGET AUTHORITY BY FUND								
General Fund	$ 94,513	$ 61,151		$ 203,282	$ 4,600,082		$ 149,795	$ 5,108,823
State Special Revenue Fund	1,074,327	15,980		1,008	53,000		6,837,143	7,981,458
Federal Special Revenue Fund	87,937			200	132,000			220,137
Enterprise Fund		175		60,241	329	$ 16,860,137		16,920,882
Internal Service Fund	70,479		$					70,479
Unspent Budget Authority	$ 1,327,256	$ 77,306	$ 0	$ 264,731	$ 4,785,411	$ 16,860,137	$ 6,986,938	$ 30,301,779

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DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	BUSINESS & INCOME TAXES DIVISION	CITIZEN SERVICES & RESOURCE MANAGEMENT DIVISION	CUSTOMER SERVICE CENTER	DIRECTOR'S OFFICE	INFORMATION TECHNOLOGY & PROCESSING DIVISION	LIQUOR CONTROL DIVISION	PROPERTY ASSESSMENT DIVISION	TOTAL
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT								
Personal Services								
Salaries	$ 4,530,053	$ 860,900		$ 1,941,905	$ 3,117,829	$ 848,227	$ 9,016,847	$ 20,315,761
Hourly Wages	(659)				(176)			(835)
Other Compensation							650	650
Employee Benefits	1,493,023	289,446		543,151	1,037,885	291,129	3,230,221	6,884,855
Personal Services-Other			$ 730			16,503		17,233
Total	6,022,417	1,150,346	730	2,485,056	4,155,538	1,155,859	12,247,718	27,217,664
Operating Expenses								
Other Services	361,198	509,798		3,177,942	2,547,078	104,343	5,919,061	12,619,420
Supplies & Materials	162,441	46,363		150,586	116,218	112,000	349,735	937,343
Communications	114,825	58,900		59,716	742,454	55,803	281,825	1,313,523
Travel	165,874	1,188		75,702	13,414	10,341	248,980	515,499
Rent	163,300	24,128		163,196	154,162	11,770	1,575,249	2,091,805
Utilities	1,217	1,887			153	79,799	1,275	84,331
Repair & Maintenance	16,222	5,989		211,802	1,178,349	111,753	256,176	1,780,291
Other Expenses	183,189	10,694		19,974	54,335	115,260	68,511	451,963
Goods Purchased For Resale						56,703,689		56,703,689
Total	1,168,266	658,947		3,858,918	4,806,163	57,304,758	8,700,812	76,497,864
Equipment & Intangible Assets								
Equipment					18,579	55,081	23,287	96,947
Total					18,579	55,081	23,287	96,947
Capital Outlay								
Buildings						(11,448)		(11,448)
Total						(11,448)		(11,448)
Local Assistance								
From State Sources	6,453,377	356,236		88,454,497			109,626,960	204,891,070
Total	6,453,377	356,236		88,454,497			109,626,960	204,891,070
From Other Sources								
Distrib from Priv Purp Trusts		2,295,071						2,295,071
Total		2,295,071						2,295,071
Transfers								
Accounting Entity Transfers				6,220		27,678,446	70,315,164	97,999,830
Total				6,220		27,678,446	70,315,164	97,999,830
Debt Service								
Installment Purchases							823	823
Total							823	823
Total Expenditures & Transfers-Out	$ 13,644,060	$ 4,460,600	$ 730	$ 94,804,691	$ 8,980,280	$ 86,182,696	$ 200,914,764	$ 408,987,821
EXPENDITURES & TRANSFERS-OUT BY FUND								
General Fund	$ 6,536,494	$ 1,488,705		$ 94,774,980	$ 7,380,695		$ 23,331,440	$ 133,512,314
State Special Revenue Fund	6,926,138	463,226			1,245,002	$ 1,374	107,715,691	116,351,431
Federal Special Revenue Fund	135,693				92,400			228,093
Enterprise Fund		213,598		29,711	262,183	86,181,322		86,686,814
Internal Service Fund	45,735		$ 730					46,465
Private Purpose Trust Fund		2,295,071					142,976	2,438,047
Permanent Fund							69,724,657	69,724,657
Total Expenditures & Transfers-Out	13,644,060	4,460,600	730	94,804,691	8,980,280	86,182,696	200,914,764	408,987,821
Less: Nonbudgeted Expenditures & Transfers-Out	(1,238)	2,299,962	730	(477)	(842)	1,908,924	70,312,662	74,519,721
Prior Year Expenditures & Transfers-Out Adjustments	828,214	(358)		(17,677)	399,393	4,544,811	1,122,041	6,876,424
Actual Budgeted Expenditures & Transfers-Out	12,817,084	2,160,996	0	94,822,845	8,581,729	79,728,961	129,480,061	327,591,676
Budget Authority	14,031,403	2,182,423		94,897,180	8,752,645	85,259,152	153,937,646	359,060,449
Unspent Budget Authority	$ 1,214,319	$ 21,427	$ 0	$ 74,335	$ 170,916	$ 5,530,191	$ 24,457,585	$ 31,468,773
UNSPENT BUDGET AUTHORITY BY FUND								
General Fund	$ 108,015	$ 4,733		$ 74,335	$ 3,287		$ 16,890	$ 207,260
State Special Revenue Fund	885,741	16,694			167,629		24,440,695	25,510,759
Federal Special Revenue Fund	132,953							132,953
Enterprise Fund						$ 5,530,191		5,530,191
Internal Service Fund	87,610		$					87,610
Unspent Budget Authority	$ 1,214,319	$ 21,427	$ 0	$ 74,335	$ 170,916	$ 5,530,191	$ 24,457,585	$ 31,468,773

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

Department of Revenue
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2008

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental (General, State Special Revenue, Federal Special Revenue, Capital Projects, Debt Service, and Permanent) fund category. In applying the modified accrual basis, the department records:

- Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary (Enterprise and Internal Service) and Fiduciary (Private-Purpose Trust and Agency) fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

Governmental Fund Category

- **General Fund** – to account for all financial resources except those required to be accounted for in another fund.

- **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include various earmarked tax accounts.
- **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds relate to Mineral Royalty Audits and New Hire Administration.
- **Debt Service Fund** – to account for accumulated resources for the payment of general long-term debt principal and interest. The department uses this fund for Renewable Resource and CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Public Law 96-510) bonds.
- **Capital Projects Fund** – to account for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds. The department collects coal severance and cigarette tax revenues in support of the Long-Range Building Program.
- **Permanent Fund** – to account for financial resources that are permanently restricted to the extent that only earnings, and not principal, may be used for purposes that support the department's programs. The department uses this fund to account for its activity in the Permanent Coal Trust Fund; the Cultural Trust Fund; the Coal Severance Tax Income and Bond Funds; the Resource Indemnity Trust and Income Funds; the Treasure State Endowment, Income, Regional Water System, and Regional Water Income Funds; and the Big Sky Economic Development Funds.

Proprietary Fund Category

- **Internal Service Fund** – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. The department's Internal Service Fund accounts for bad debt collection activity.
- **Enterprise Fund** – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. Department Enterprise Funds include the Liquor Division fund, which maintains a low merchandise inventory by purchasing liquor from vendors as it fills orders from stores.

Fiduciary Fund Category

- **Private-Purpose Trust Fund** – to account for activity of any trust arrangement not properly reported in a pension fund or an investment trust fund where the principal and income benefit individuals, private organizations, or other governments. Department private-purpose trust funds are used for unclaimed property, escheat property, and unlocated mineral owners.
- **Agency Fund** – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal (to the State) clearing account activity but these must have a zero balance at fiscal year-end. The department uses agency funds as clearing accounts to facilitate the distribution of receipts from one-stop licensing, county collections, bad debt collections, dishonored checks, Automated Clearing House (ACH) collections, receivables, and gas and oil taxes.

2. General Fund Balance

The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department's total assets placed in the fund exceed outstanding liabilities, resulting in positive ending General Fund balances for each of the fiscal years ended June 30, 2008, and June 30, 2007. These balances reflect the results of the activity of the department and not the fund balance of the statewide General Fund.

3. Direct Entries to Fund Balance

Direct entries to fund balances in the General, State Special Revenue, Debt Service, Capital Projects, Enterprise, and Permanent funds for each of the fiscal years ended June 30, 2008, and June 30, 2007, are primarily entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

4. Prior Year Revenue Adjustments

The department accrued individual income and corporation tax refunds payable of $94,523,801 and $86,760,688 and liquor revenues receivable of $16,072,757 and $14,229,532 at June 30, 2007, and June 30, 2006. It reversed these accruals as prior year revenue adjustments in the next fiscal year. The related tax refunds paid in the next fiscal year were recorded as reductions of current year budgeted revenues when paid. The related liquor collections were recorded as budgeted current year revenues in the next fiscal year when collected and nonbudgeted current year revenues when accrued.

5. Revenues Over (Under) Estimate

The Schedule of Total Revenues and Transfers-In for the fiscal year ended June 30, 2008, reports actual tax revenues over the estimate by $27,347,655 in the General Fund. The General Fund amount is primarily attributable to individual income and corporation taxes not meeting recorded estimates by $38,417,200 and $5,389,870, respectively, and other taxes exceeding recorded estimates by $71,154,725 for the reasons discussed in Note 4 and due to economic factors.

The Schedule of Total Revenues and Transfers-In for the fiscal year ended June 30, 2007, reports actual tax revenues under the estimate by $22,005,635 in the General Fund and $36,109,843 in the State Special Revenue Fund. The General Fund amount is primarily attributable to individual income taxes not meeting recorded estimates by $49,906,453 and combined oil and gas taxes and corporation taxes exceeding recorded estimates by $10,093,992 and $12,840,774, respectively, for the reasons discussed in Note 4 and due to economic factors. The State Special Revenue Fund amount is primarily attributable to (a) $50,000,000 estimate for a combined oil and gas taxes clearing account with no expected activity, and (b) cigarette and tobacco taxes exceeding estimates by $7,464,953.

6. Operating Expenses – Other Expenses

The Operating Expenses – Other Expenses on the Schedule of Total Expenditures and Transfer-Out for the fiscal year ended June 30, 2008, for the Information Technology & Processing Division of $94,633,382 includes $94,578,457 for property tax refunds of up to $400 per taxpayer issued in accordance with Chapter 6, Special Session Laws of May 2007.

7. Nonbudgeted Expenditures & Transfer-Out

Nonbudgeted Expenditures & Transfers-Out in the Permanent Fund on the Schedules of Changes in Fund Balances & Property Held in Trust and Accounting Entity Transfers on the Schedule of Total Expenditures & Transfers-Out for the fiscal years ended June 30, 2008 and 2007, are related to coal tax transfers required in state law.

8. Prior Year Expenditure Adjustments

The department recorded $4,552,876 of payments to vendors for liquor merchandise received in fiscal year 2005-06 as prior year expenditure adjustments in fiscal year 2006-07.

9. Unspent Budget Authority

The Schedule of Total Expenditures and Transfers-Out for the fiscal year ended June 30, 2008, includes Unspent Budget Authority from statutory appropriations of $4,151,246 in the General Fund and $7,926,491 in the State Special Revenue Fund. The Schedule of Total Expenditures and Transfers-Out for the fiscal year ended June 30, 2007, includes Unspent Budget Authority from statutory appropriations of $153 in the General Fund and $25,069,997 in the State Special Revenue Fund.

10. Loss Contingencies

Certain centrally assessed companies have protested approximately $13 million in state property taxes, which have been included as protested revenue or in fund balance on the department's financial schedules as of June 30, 2008. The department had $7,105,039 in the protested property tax State Special Revenue Fund at June 30, 2008, that was available for refunds or centrally assessed protested property taxes. Other refunds or protested property taxes would come from the university millage State Special Revenue Fund or from the General Fund.

Department of Revenue

Department Response

Montana Department of Revenue

Dan Bucks
Director

Brian Schweitzer
Governor

November 7, 2008

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LEGISLATIVE AUDIT DIV.

Tori Hunthausen, Legislative Auditor
Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Dear Ms. Hunthausen:

Thank you for the opportunity to respond to the recommendations raised in the Financial-Compliance Audit Report of the Montana Department of Revenue for the fiscal years ended June 30, 2007 and 2008. Our response to the recommendations raised in the report is as follows:

Recommendation #1

We recommend the department accrue liabilities for metal mines license tax allocations to counties in accordance with state law and accounting policy.

Concur. Prior to the change in statute requiring bi-annual payments of the metal mines license tax, rather than annual payment, an accrual of revenues and the related payable to counties at fiscal year-end was not necessary. Although the department has consistently accrued estimated revenues and distributed the metal mines license tax to counties when due, the department concurs with the recommendation that an accrual of this payable should be recorded at fiscal year-end.

The department has since modified its work plan at fiscal year-end to ensure an accrual is recorded, and as the audit report indicates, the department did record this obligation for the fiscal year ended June 30, 2008.

Recommendation #2

We recommend the department properly classify current and prior year revenue activity, liability and fund balance accounts, and fiscal year for budgetary transactions in accordance with state law and accounting policy.

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Partially Concur. The department concurs with the recommendation that classification of liability and fund balance accounts and the fiscal year for budgetary transactions should be recorded in accordance with state accounting policy. The department; however, concludes, and the Department of Administration agrees, that state accounting policy is silent on the major issues raised in this recommendation and in the report under the heading "Prior Year Revenue Adjustments". The department also recognizes that changes in how certain accounting transactions are classified when recorded could make the financial statements more meaningful or understandable to the reader. Although ***the major items cited in the report have no financial impact to the bottom line of the state's financial statements***, the department is willing to defer to the professional judgment of the legislative audit division (LAD) and will modify how these transactions are recorded in the future. But, the department will also work with the Department of Administration Accounting Bureau to address these issues in state accounting policy in order to eliminate these differences in opinion and fill the silence that currently exists in state accounting policy on what guidance is provided in these areas. These changes in turn will effect how current year/prior year revenue is presented in future financial statements included in the blue book audit report.

Prior Year Revenue Adjustments/Liability Accounts

The audit report cites MOM policy 2-0250.10, which describes steps an agency should take if accounting transactions were recorded in error. The department contends this policy is not applicable, as the entries in question are not recorded in conflict with state accounting policy.

The department has consistently recorded the refund accruals of withholding tax and corporation license tax, liquor revenue accruals and distributions of natural resource taxes to local governments as far back as the department can reasonably attest. Likewise, the department has consistently been audited by the LAD on these very transactions as far back as the department can reasonably attest. These transactions are reviewed during each financial compliance audit by LAD staff to gain an understanding of the transactions and how they are recorded to ensure these transactions are recorded consistently and in accordance with state accounting policy. In fact, these transactions are a constant review item each audit as the associated dollar amounts are typically some of the largest transactions recorded by the department each fiscal year end. Since the method for recording these transactions has never been an issue raised in a prior audit, the department has accounted for these transactions in a consistent and well documented manner each fiscal year-end. The report recognized this and indicated *"we have found the department has procedures for ensuring its activity and account balances are recorded consistently with prior years' practices"*.

The report indicates the department recorded receivable accruals in accordance with state accounting policy and that the accruals were supported and reasonable, but that the department was inconsistent and noncompliant with state accounting policy when accruing refund payables and liquor sales at fiscal year-end. Again, state accounting policy is silent in regards to accruing these types of transactions. MOM policies 2-1170.10 and 2-1170.11 provide guidance on accruals of receivables in modified accrual funds and the treatment of current year revenue versus prior year revenue. It does not discuss similar treatment for refund payables accrued. In fact, Department of Administration indicates they have not provided specific guidance in regard to entries for refunds of revenues accrued or recording entries in full-accrual funds used for recording liquor activity in the enterprise fund, but this is something that will be addressed in the future.

Under generally accepted accounting principles the department's method of accruing refund payables is acceptable and proper. There is not a requirement to capture current year activity and reclassify the activity as prior year. As well, the classification between current year revenue and prior year revenue does not impact the state's comprehensive financial report, as all of the revenue included in this issue is reported as current year revenue.

The department has consistently recorded the distribution of natural resource taxes to local governments each fiscal year-end using liability account 2101, Accounts Payable, rather than liability account 2540, Due to Local Governments. Although there has been no impact to the overall state's financial statements other than the presentation of which liability account these distributions are recorded to, the department recognizes under state accounting policy it is proper to record these transactions using Due to Local Governments. The department changed how these transactions were recorded at fiscal year-end 2008 to follow the recommendation of the legislative auditor and will continue to record the accrual of these transactions in the future using the Due to Local Governments liability account.

Fund Balance Accounts

The department concurs with the recommendation to adjust fund balances reserved for the amount of long-term advances, and as the audit report indicates, an adjustment was made at fiscal year-end 2008 to bring the reserved fund balance to the appropriate levels. The department has made adjustments to the work plan used at fiscal year-end to ensure fund balances are reviewed and adjusted to properly reflect the reservations of fund balance.

Budgetary Transactions

The department requested to increase its statutory appropriation for two fiscal years on the same document. This request was recorded under the proper program year and budget year and the increased authority was reflected on the state's financial system in the proper budget year. By making the request for two years on the same document, the transaction year for the second year of the request was in error and was missed when the request was reviewed and processed. The department recognizes multiple year requests need to be processed on separate documents and will change its process to ensure the transaction date aligns with the year of the appropriation authority request.

Revenue estimates need to be recorded in the state's financial system in order to record transactions to a particular accounting designation. Both the Office of Budget and Program Planning and the department record revenue estimates depending upon the revenue source. The department recognizes that potentially some of these estimates could be duplicated and will modify its procedures to avoid duplication in the future.

Recommendation #3

We recommend the department analyze and adjust its delinquent account collection rate as often as necessary to be commensurate with costs, in accordance with state law.

Concur. As part of the biennial budget submission process, the department recently analyzed the Internal Service Fund used to partially fund the Collection Services Program. Due to the increasing fund balance associated with the program, the department has lowered the commission rate from 5% to 3% effective October 1, 2008. This analysis projects the fund balance at the end of the 2011 biennium to be at a level of nine months of working capital. The department determines this level to be necessary for proper administration of the program due to the timing of when the majority of the collections occur. The department will continue to monitor the fund balance periodically and adjust the commission rate as necessary to ensure fee revenues are commensurate with costs of the program and the current fund equity is reduced.

Recommendation #4

We recommend the department stop investing undistributed combined oil and gas tax revenues.

Concur. Prior to the change in statute in 2003, accumulated earnings on undistributed combined oil and natural gas tax revenues were distributed to local governments. The department invested money in the Board of Investments' Short-Term Invest Pool (STIP) to meet this statutory obligation. Under current statutory language, all proceeds not specifically distributed are remitted to the state general fund; however, the statute is silent on the investment of funds prior to distribution. The department continued to invest funds in STIP after the change in law and remitted the earnings to the state general fund. Recognizing current statute does not provide for the department to invest the funds prior to distribution, the department is no longer investing these funds. The department has since notified the Board of Investments of this change who is now investing these funds in the pooled investment fund and distributing the related earnings to the state general fund.

Tori Hunthausen
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Recommendation #5

We recommend the department revise procedures to ensure excess vacation leave is properly calculated and used by employees or forfeited in accordance with state law.

Concur. During the legislative audit a calculation error was found that caused seven employees to accumulate more vacation leave than state law allows. The department relied on information included in the leave accrual reports that was based on pay period ending dates, while the annual leave policy dates are based on the calendar year. These differences lead to misinterpretation of the information. As well, it was determined employee information provided through the Department of Administration's DocuAnalyzer program was inaccurate.

The department has since resolved these differences by adjusting the leave balances of the affected employees to become compliant with state policy. The department has also revised procedures to ensure excess vacation leave is calculated properly by implementing a process to manually verify the leave calculations. The department is working with the Department of Administration to improve the DocuAnalyzer model and to redesign the educational materials provided to agencies. This information is to be presented at the December SABHRS users meeting.

Recommendation #6

We recommend the department report corporation license tax nonfilers and delinquent filers to the Secretary of State as required by state law.

Concur. The department will continue to review and notify the Secretary of State of corporations that have not paid or filed a return as required by law to the best of our ability. As indicated in our response to the prior audit, to effectively meet the requirements of the law, the Secretary of State would need to require a taxpayer identification number; i.e. federal employer identification number or social security number, which they do not currently require. With this information the department can effectively match the Secretary of State information with tax information. The department anticipates requesting legislation that would require taxpayer identification numbers be provided to the Secretary of State.

Recommendation #7

We recommend the department director call meetings of the Board of Review as required by state law.

Concur. Meetings of the One-Stop Board of Review have been called in the past by taking into consideration schedules of the board members and whether current issues warranted a quarterly meeting. This practice did not always cause a meeting to convene each calendar quarter as state statute dictates. The department recognizes

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the need to call meetings of the board according to state statute and will attempt to schedule future meetings to meet statutory obligations.

Thank you for allowing us the opportunity to review the audit report and respond to the recommendations included therein. As well, we appreciated the open discussion of the report with you, Jim Gillette and Pearl Allen prior to the final outcome. Finally, please thank your staff who participated in the audit for their professionalism and their willingness to work with the department.

Sincerely,

Dan Bucks

Dan Bucks, Director

c: Janet Kelly, Director – Department of Administration